Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Thomson	Analyst:	Kimberly Pantoja	Bill Number:	AB 1734
Related Bills:	See Legislative History	Telephone:	845-4786	Introduced Date:	01/06/2000
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Employer Provided Health Insurance Premiums Refundable Credit

SUMMARY

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would provide a refundable credit for amounts paid or incurred by an eligible employer to provide health coverage for covered individuals with incomes below 250% of the federal poverty level.

EFFECTIVE DATE

As a tax levy, this bill would apply to taxable and income years beginning on or after January 1, 2000.

LEGISLATIVE HISTORY

AB 1262 (1999/2000), which proposed an Employer Provided Health Care Coverage Credit, failed passage due to missing the deadline for passing out of the house of origin. AB 1172 (1999), AB 2520 (1998), and AB 148 (1997) each proposed an Employer Provided Health Care Credit for Farmworkers, and each failed passage in policy committee.

SPECIFIC FINDINGS

Under federal law, to which California conforms, an employer's contribution to an accident or health plan for the benefit of the employee, employee's spouse or dependents is not includable in the employee's gross income.

Existing federal and state laws allow ordinary and necessary business expenses to be deducted, which would include health care coverage premiums paid for employee accident or health plans.

Existing state and federal laws provide various tax credits that are designed to provide tax relief for taxpayers who incur certain expenses (e.g., child and dependent care credit) or to influence behavior, including business practices and decisions (e.g., research credits).

Current federal and state laws do not currently provide credits for any health care costs. Prior **state law** would have provided a small-employer health coverage tax credit (SB 2260, Ch. 1521, Stats. 1988). However, that credit was repealed before becoming operative.

Board Position:			Department Director	Date
______ S	______ NA	______ NP	Gerald H. Goldberg	3/9/00
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This bill would provide a credit for amounts paid or incurred during the taxable or income year by an eligible employer to provide health coverage for a covered individual with income below 250% of the federal poverty level.

This bill specifies the amount of the credit shall be $65 per month per covered individual. To qualify for the credit, an eligible employer must employ on the average during the year no more than 25 full-time permanent employees and pay or incur at least 80% of the covered individual's health insurance premium during the year. The employer shall make participation in a health plan available to all full-time employees at least annually and to all newly hired individuals within 30 days of the date of employment.

This bill specifies that no deduction would be allowed for the same expenses for which the credit was allowed.

This bill specifies that any excess credit that exceeds the taxpayer's tax liability shall be credited against any other amounts due and the balance, if any, shall be refunded to the taxpayer.

Policy Considerations

Historically, refundable credits (such as the state renter’s credit, the federal Earned Income Tax Credit and the federal credit for gasoline used for farming) have had significant problems with fraud.

This bill does not specify a repeal date. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness.

This bill does not restrict the health care coverage credit to employees who are employed within California.

Implementation Considerations

The department has not administered a refundable tax credit under the Personal Income Tax Law (PITL) since the refundable renter’s credit was suspended in 1993. The department has never administered a refundable tax credit under the B&CTL. Establishing a refundable tax credit program would have a significant impact on the department’s programs and operations and require extensive changes to forms and systems.

This bill does not modify the hierarchy of B&CTL tax credits (Section 23036), thus the order in which credits would be applied before this credit would be refunded is unclear. The existing hierarchy under PITL includes refundable credits (Section 17039).

The bill uses terms that are undefined, i.e., “full-time permanent employee,” "covered individual," "health insurance premium," and "health plan." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of the credit.

Since this bill lacks a definition for "covered individual," it is unclear whether this bill would apply to dependents or just the employee. For example, if the employer paid 80% of the health insurance premium for a family of four (consisting of the employee, the spouse and two children), the employer could potentially receive a credit of $3,120 ($65 x 4 x 12). In addition, many health insurance plans do not establish the amount of premiums on a per person basis. In many cases, premiums are determined on the basis of family size (i.e., single employee, employee plus one additional person, and employee plus more than one additional person). As a result, it is unclear when an employer would satisfy the 80% requirement. For example, if an employer paid 75% of the cost of the premium for a family of four, but that amount was more than 80% of the cost of premiums for a family of two, would the employer be entitled to a credit based on two covered individuals or zero credit because, on an equal pro rata basis, the employer paid only 75% of the cost of each family member covered under the plan.

The bill specifies "covered individuals with incomes below 250% of the federal poverty level." According to the 1999 U.S. Department of Health and Human Services Federal Poverty Guidelines, the poverty guidelines are sometimes loosely referred to as the "federal poverty level" (FPL), but that term is ambiguous and should be avoided in situations (e.g., legislative or administrative) where precision is important. There are no universal administrative definitions of "family," "family unit," or "household" that are valid for all programs that use the poverty guidelines. The absence of a definition that identifies the author's intent complicates the administration of this credit.

The 1999 U.S. Department of Health and Human Services Poverty Guidelines indicate the following (not including Alaska and Hawaii):

Size of Family Unit	48 Contiguous States and D.C.	x250%
1	$8,240	$20,600
2	11,060	27,650
3	13,880	34,700
4	16,700	41,750
5	19,520	48,800

For each additional person add $2,820.

Since the “federal poverty level” generally refers to more than an individual, it is unclear how the taxpayer or the department would determine eligibility for the credit. For example, it is unclear whether the employer would be eligible for the credit if the covered individual has more than one source of income (i.e., second employment or covered individual's community property interest in a spouse's income) which would raise the covered individual's income level above the threshold. In addition, if covered individuals include household members, it's unclear how the income of these covered individuals would affect the employer's eligibility for the credit. Each covered individual might be required to disclose to the employer personal information regarding second employment, spouse's income, family or household income, and possibly family size.

The department has no ability to verify household or family income. Tax benefits, such as the renters credit, generally are tied to adjusted gross income (AGI) amount, with a maximum AGI for qualifying married couples filing a joint return and heads of household and a lower maximum AGI for qualifying single filers.

This bill specifies for an employer to qualify for this credit, participation in a health plan shall be made available to all full-time employees at least annually and to all newly hired individuals within 30 days of the date of employment. The FTB has no basis to verify that the employer has fulfilled this requirement.

The bill provides a $65 per month per covered individual credit so long as the eligible employer pays or incurs at least 80% of the covered individual's health insurance premium during the taxable or income year. The bill then further provides that the credit shall be in lieu of any deduction to which the eligible employer may otherwise be entitled for expenses on which a credit is claimed. However, since the credit is not computed as a percentage of the expenses paid or incurred, it is unclear how the provision dealing with the disallowed deduction is to be interpreted – does it disallow a deduction for **any** expenses which qualify the eligible employer for the credit (i.e., those expenses necessary to satisfy the 80% threshold requirement), or does it only disallow the $65 per month per covered individual amount for which the credit is allowed each month? The author may want to clarify her intent on this issue.

FISCAL IMPACT

Departmental Costs

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved, but are expected to be significant.

Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of AB 1734 As Introduced 1/6/00 [$ In **Millions**]		
2000-01	2001-02	2002-03
-$540	-$505	-$555

Note that the estimate includes self-employed individuals who have no employees. The bill would be effective for income years beginning on or after January 1, 2000, with enactment assumed after June 30. Estimated losses would be under the Personal Income Tax and Bank and Corporation Tax Laws.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The number of eligible employers who pay at least 80% of health insurance premiums for covered individuals and the number of covered individuals (California employees and dependents) would determine the revenue impact of this bill. The credit would extend to employers who already provide insurance as well as employers who commence coverage.

A brief summary of the methodology follows. Employment data were the starting point for developing the estimate. Employment data were adjusted to eliminate those employed by tax-exempt organizations and any ineligible employers and to reflect annual growth. In 2000, eligible employers (firms with 25 or fewer full-time permanent employees) will employ approximately three million individuals. Based on population statistics and other information, it is estimated that roughly 45% of these employees have incomes of less than 250% of the FPL. Data were further adjusted for household size to include dependents as well as employees (assumed California employees and their resident dependent).

According to a new survey of employers recently released, the percentage of individuals currently insured is 41% for firms with three to nine employees and 62% for firms with ten to 50 employees. For smaller firms consisting of ten to 25 employees, insurance coverage is assumed to be less than that for firms with ten to 50 employees. For firms with ten to 25 employees, coverage is estimated at 50%. Relevant percentages (41% for firms with zero to nine employees and 50% for firms with ten to 25 employees) were applied to estimate the number of individuals currently insured by eligible employers. For 2000, this number is estimated at 585,000 individuals. For this group, credits generated would total $456 million [585,000 x $65 x 12-months].

Employers who currently provide insurance for targeted employees would forego expense deductions for insurance premiums. Under current law, the tax benefit of these deductions would be on the order of $62 million for the 2000 income/taxable year.

To an employer, the tax benefit of the proposed refundable credit would always exceed that of the expense deduction. Assuming an average monthly premium of $155 and the employer's share at 85%, a deduction of $1,581 would provide a tax benefit of $134 (assuming an average tax rate of 8.5%) as compared with a maximum credit of $780 [$65 x 12].

An incentive effect for expanded health coverage was estimated to derive the number of uninsured who would become insured under the proposal. Applying the applicable incentive percentage for each year projected the incremental number of individuals that become insured (coverage assumed effective at mid-year). For 2000, this number is estimated at 75,000 individuals. For this group, credits generated would total $29 million [75,000 x $65 x 6-months].

Netting revenue losses estimated for the proposed credit ($485 million) with gains from foregone expense deductions ($62 million) derived the liability year estimate of $424 million for 2000. In 2001, the liability year estimate grows to $483 million; in 2002, to $545 million. Liability year estimates were converted to the cash flow estimates in the table. Cash flow estimates reflect the ability of some taxpayers to accelerate tax benefits by adjusting their estimated tax payments.

Sources of data and other information used in developing this estimate include the Employment Development Department, Bureau of Labor Statistics, Small Business Administration, and independent surveys of employers.

BOARD POSITION

Pending.